BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Conservation Incentive Inquiry	DOCKET NO. U-100522

COMMENTS OF PUBLIC COUNSEL IN RESPONSE TO THE STATEMENT OF INQUIRY

June 4, 2010

I. INTRODUCTION

1. Pursuant to the Commission's Notice of Opportunity to File Written Comments (May 13, 2010), Public Counsel files these Comments on the Statement of Inquiry on matters raised in the Amended Consolidated List of Issues (May 19, 2010). As Public Counsel noted in its Initial Statement of Issues, many of these issues have been addressed in prior proceedings. The issues list raises a wide range of important and complex matters, many of which could alone warrant extensive policy and technical commentary. While a comprehensive analysis is beyond the scope of these comments, a number of the issues have been the subject of in-depth analysis by the Commission and parties in prior Commission proceedings. Where appropriate, these comments reference and summarize the analysis in these other proceedings.

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II. COMMENTS

General

1) ***Definitions.*** **What is decoupling? What is lost margin? How is it measured? What are fixed costs?**[1]

What is Decoupling?

2. The term "decoupling" is a general term used to describe rate design or ratemaking proposals that "decouple" or "de-link" a utility company's revenues from its sales of electricity or gas.[2] There are multiple ways to design decoupling mechanisms and the term does not imply a description of any specific mechanism. A decoupling mechanism in effect seeks to replace revenue which has assertedly been lost due to conservation.

3. In reviewing the PSE gas decoupling proposal filed in 2006, the Commission stated:

> Decoupling is a ratemaking and regulatory tool that breaks the link between a utility's recovery of fixed costs and a customer's energy consumption. From a utility perspective, it is a means to ensure recovery of a significant part, or even all of its fixed costs regardless of reduced consumption. One potential source of reduced consumption, at least on a per customer basis, is conservation undertaken by individual customers. Consumption may also be lower at times for other reasons including more energy efficient building codes and appliances, improved insulation, warmer than normal weather, and, of course, price elasticity.[3]

4. A common feature (and flaw) of virtually all decoupling mechanisms proposed in Washington (and elsewhere) is that they compensate the company for declines in energy usage due to a wide range of causes beyond the company's own conservation programs, including

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[1] These comments include the issue statement from the Commission's notice at the beginning of each section.
[2] Decoupling covers a spectrum between full and limited decoupling. Full decoupling completely insulates a utility's revenue collections from any deviation of actual sales from expected sales, creating a guarantee that all authorized revenue will be recovered regardless of actual sales. "Partial" or "limited" decoupling insulates only a portion of the utility's revenues. A variation in sales results in a partial true-up of revenues. Limited decoupling focuses only on specified causes of variations in sales.
[3] *WUTC v* PSE, Docket Nos. UE-060266 & UG-060267, Order 08, January 5, 2007, ¶ 53 (hereafter "PSE 2006 GRC").

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economic downturn, improved building codes, price elasticity, and the eventual replacement of older appliances with newer, more efficient versions, outside of company sponsored programs.[4]

5. A second key feature of decoupling is that it typically focuses on average usage per customer rather than overall sales and revenues of the utility. Decoupling defined in this way links the need for a revenue adjustment to average customer use and explicitly does not consider total company sales, revenues, or rate of return. In other words, decoupling can provide additional revenue for a utility company even where overall sales and revenues are increasing and without regard to whether the utility rate of return is impaired.

6. This aspect of decoupling reflects its character as a "single issue ratemaking" mechanism which focuses on and tracks a single element of declining revenue (average use per customer) without taking into account other increasing or offsetting revenue increases or cost declines. Single issue ratemaking is strongly disfavored in ratemaking for this reason since it does not take into account the overall financial situation of the utility. The Commission has recognized that in this regard decoupling "risks over-earning by the company and over-paying by the customers."[5]

What is lost margin? How is it measured?

7. The Commission has defined "margin revenues" as "the revenue necessary for a utility to recover its total cost of service net of purchased gas expenses and other expenses treated as 'flow through' items in rates[.] A utility's per customer margin revenue is simply the total cost of service, as determined in the most recent general rate case, divided by the number of

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[4] For example, PSE's gas decoupling proposal in docket UG-060267 was "intended to ensure that PSE receives the authorized per customer 'margin revenue' regardless of variations of sales volumes due to weather, conservation or other causes." PSE 2006 GRC, Order 08, ¶56.

[5] PSE 2006 GRC, Order 08, ¶ 63.

customers." [6] A lost margin mechanism essentially serves the same purpose as decoupling. With regard to measurement of lost margins, in approving Avista's decoupling mechanism, the Commission identified a "bottom up" approach as the most fair and equitable means to determine the amount of lost margin appropriate for recovery. Under this approach, the Commission began with the evidence of Avista's own programmatic conservation efforts, and added the ascertainable impacts of its non-programmatic efforts (such as customer education). This was the amount fixed for later deferral and recovery.[7]

What are fixed costs?

8. As a general matter, "fixed costs," also referred to as "constant costs," are defined as costs that do not vary with the volume of energy usage. . In short run marginal cost analysis the capital cost of plant and equipment, as well as some operating costs, are treated as constant.[8] Fixed costs are distinguished from variable costs in traditional cost analysis, particularly in the analysis of short run marginal cost.[9] On the other hand, a frequently stated principle of cost analysis is that in the long run, all costs are variable.[10]

9. Setting aside the academic discussion of what constitutes fixed versus variable cost, "fixed costs" are discussed in the context of lost margin recovery because utilities and other

[6] *Id.*, ¶ 56, n. 38.
[7] *WUTC v. Avista,* Docket Nos. UE-090134 & UG-090135, consolidated with UG-060518, Order 10, December 22, 2009, ¶ 295 (hereafter "Avista 2009 GRC"). Public Counsel has expressed concern about the accuracy of savings claims tied to non-programmatic efforts such as education, in part because savings may be double counted (since a customer may participate in a conservation program as a result of conservation education/outreach efforts). However, Public Counsel does agree that the "bottom up" approach is the best means of calculating lost margins.
[8] Bonbright, *Principles of Public Utility Rates*, p. 320. *See also, WUTC v. PacifiCorp,* Docket No. UE-050684, Order 04, ¶ 103 (hereafter "PacifiCorp 2005 GRC"). The PacifiCorp electric decoupling proposed calculating a fixed cost revenue requirement based on generation, transmission, and distribution costs.
[9] Goodman, *The Process of Ratemaking*, Public Utility Reports, 1998, p. 382-389.
[10] *See, e.g.* Bonbright, p. 326 (discussing qualifications to the application of this principle.)

advocates commonly justify decoupling as a remedy to the alleged under-recovery of "fixed costs" already authorized by the Commission. Public Counsel presented expert testimony in the recent Avista decoupling case which showed that due to overall volume changes (increases) in sales of natural gas, Avista was not suffering from an inability to recover its fixed costs between rate cases. Avista's overall therm sales trends for Schedule 101 (residential and small commercial) were generally increasing. The persistent customer growth, offset somewhat by declining usage per customer, has produced a generally positive trend in the Company's overall therm sales for Schedule 101 since 1999.[11]

10. In approving Avista's current decoupling mechanism, the Commission noted the utility's argument that decoupling was needed to provide fixed cost recovery, but stated "we disagree that decoupling's purpose is so broad."[12] In the same case, the Commission also rejected a proposal to increase fixed cost recovery by simply increasing the "customer charge"—the basic monthly paid by all customers regardless of usage, and concomitantly reducing the volumetric charge. The Commission observed that this would decrease the incentive for a customer to conserve his or her own usage. On this issue, Public Counsel had provided expert witness analysis showing that, historically, the natural gas industry has relied on recovering the majority of all costs, including fixed costs, through volumetric rates. Notwithstanding decades of declines in average natural gas use per customer, data for 1999-2008 show the average return on equity for natural gas utilities has been a healthy 12 percent, and there is no evidence of

[11] Avista 2009 GRC, Direct Testimony of Michael L. Brosch on behalf of Public Counsel, Exh. No. MLB-1T, pp. 22-23.
[12] Avista 2009 GRC, Order 10, ¶ 291.

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shortfall in cost recovery. [13]

2) Recovery of Conservation Program Costs. **Are the utilities' conservation program costs recovered from ratepayers in a timely manner?**

a. If cost recovery is untimely, please describe how and why.

11. There is no evidence of a problem with the timeliness of the cost recovery for utility conservation programs. Programs are fully paid for by utility customers through a surcharge on the customer bill, separate from basic utility volumetric rates and the monthly customer charge. Alternatively, some of the natural gas utilities recover the costs of their conservation programs through deferred accounting, as part of their PGA. Utilities file information regarding their programs and budgets with the Commission on an annual basis
and receive approval to recover the program costs through the surcharge or PGA, typically at an open meeting without extensive procedural process.

b. Are there other methods of funding conservation programs that would be more efficient and effective at acquiring conservation resources?

12. One alternative method of funding conservation resources is offered by the Energy Trust of Oregon (ETO) approach.[14] The ETO is an independent non-profit organization created by the Oregon Legislature and overseen by the Oregon Public Utility Commission. The genesis of ETO was the perception that economic pressures had discouraged utility pursuit of conservation and the need for an entity devoted exclusively to ratepayer interests in energy conservation and renewable energy. It began operations in 2002 and was funded by a three percent public purpose charge paid by electric utility customers. ETO became the principal administrator of energy

[13] Avista 2009 GRC, Cross-Answering Testimony of Glenn Watkins, Exh. No. GAW-3T, p. 4 (Table 1 – Value Line Natural Gas Utility Rate of Return on Common Equity).
[14] Other states, including Vermont, have similar third-party administrators for utility conservation programs.

efficiency and renewable energy programs for Oregon's two largest electric utilities.[15] The program was later expanded to include gas utilities serving Oregon, including Cascade Natural Gas, and Northwest Natural Gas.[16]

13. Under a pilot program established in a Northwest Natural Gas case settlement in Washington, ETO provides select ETO energy efficiency services, resources, and gas-only cash incentives to Northwest Natural Gas customers in its southwest Washington service territory. The results of the pilot will be reviewed in early 2011.[17] The pilot evaluation also will include a third-party benchmarking study which will compare NW Natural's ETO-delivered program against other DSM programs in Washington. The company will use the benchmarking efforts to extrapolate what it might cost the company to deliver its own DSM programs, as well as potential costs to use a Washington-based DSM program administrator.[18]

14. While Public Counsel does not have a position at this time as to whether Washington should adopt the Energy Trust model, it is worthy of consideration as an alternative path. It has a sufficient track record in Oregon in both gas and electric industries that could provide extensive data and results for analysis. The review of the Northwest Natural Gas pilot in Washington will provide valuable information regarding its experience in this state.

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[15] Energy Trust of Oregon, 2009 Strategic Plan, pp. 1 and 3. *See also* ETO 2009 Annual Report to Oregon PUC. Both documents contain significant detail about ETO operations, costs, and results.
[16] Both companies also provide service in Washington.
[17] ETO Power Point Presentation to Washington Utilities and Transportation Commission, May 12, 2010.
[18] Northwest Natural Energy Efficiency Plan for Washington, Last Revised February 18, 2010, Docket UG-091044, p. 2.

Impact of Conservation Resource Development on Rate of Return

3) ***Statement of the Issue.*** **Does the development of conservation resources deny the utility an opportunity to earn its allowed rate of return? Would an attrition study be the best way to determine this question? Are there alternative ways of making such a determination?**

15. Utilities have not been able to demonstrate that they are denied the opportunity to earn their allowed return as a result of developing conservation resources. As discussed in response to question number 4 below, the magnitude of lost margins from utility-sponsored conservation programs is only a small fraction of all lost margins, and likely not enough to impact the overall financial health of a utility.

16. In the evaluation of PSE's Electric Conservation Incentive Mechanism (ECIM), Blue Ridge conducted an analysis of PSE's rate of return on electric rate base, and found that the Company's realized rate of return was below the allowed rate of return in 2004, 2007, and 2008. However, since actual electric sales exceeded forecast electric sales and electric sales per customer increased in 2008, Blue Ridge surmised that the Company's conservation programs did not appear to be a significant driver of the under run, and if conservation was a disincentive, it was only a minor one.[19] Blue Ridge added the calculated lost margin in 2007 and 2008 to the realized return and found that the rate of return on electric rate base would have only increased from 8.25 percent to 8.29 percent in 2007 and from 6.51 percent to 6.71 percent in 2008. In both years, the realized rate of return on electric rate base, including lost margins, would still slightly under run the approved levels of 8.40 percent and 8.38 percent respectively.[20]

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[19] *Independent Third-Party Evaluation of PSE's Electric Conservation Incentive Mechanism,* Prepared by Blue Ridge Consulting Services, Inc., Phase I Report , October 24, 2009, pp. 67-68 (hereafter "Blue Ridge Phase I Report"). The Phase I Report covered the first two years, 2007-2008, of the three year pilot that concluded December 31, 2009.

[20] Blue Ridge Phase I Report, pp. 67-68.

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17. Furthermore, from an economic perspective, conservation programs offer benefits to the utilities. For example, conservation is a "least cost" resource that presents lower financial risk and lower emissions risk.[21] The ECIM evaluation also discussed complex interactions of factors that impact financial performance, and highlighted some of the benefits that are associated with conservation as a resource. The report states,

> However, there are also well-accepted benefits associated with energy efficiency as a resource, such as the short-term value in the avoidance or reduction of energy purchase. Assuming that PSE's marginal cost is less than or equal to the market marginal cost, PSE can sell excess capacity or use it as a reserve to enable sales on the spot market. There is also significant risk in building physical plant, especially in the current environment. Some of these risks (economic, volumetric, and even political) manifest themselves in the volatility of market prices for power, fuel, and emissions as well as the volatility of economic growth forecasts and transmission assumptions….There is real value in reducing exposure to the uncertainty in energy supply costs. [22]

18. The current continuous cycle of rate cases provides the best forum for reviewing whether revenue levels are allowing the opportunity to earn a reasonable return. An attrition study is not necessary for this reason.

***4) Magnitude of the Risk.* How much lost margin can be attributed to each utility's conservation programs? How much lost margin can be attributed to the other types of conservation referenced in question 6 below?**

19. Lost margins attributed to a utility's conservation programs are not reported to the Commission on an ongoing basis so current information for each utility is not available. However, the review of lost margins has been the subject of comprehensive review in past Commission proceedings and some data is available.

20. A common component of all the decoupling mechanisms proposed before this Commission is that the proportion of lost margins due to Company-sponsored conservation has

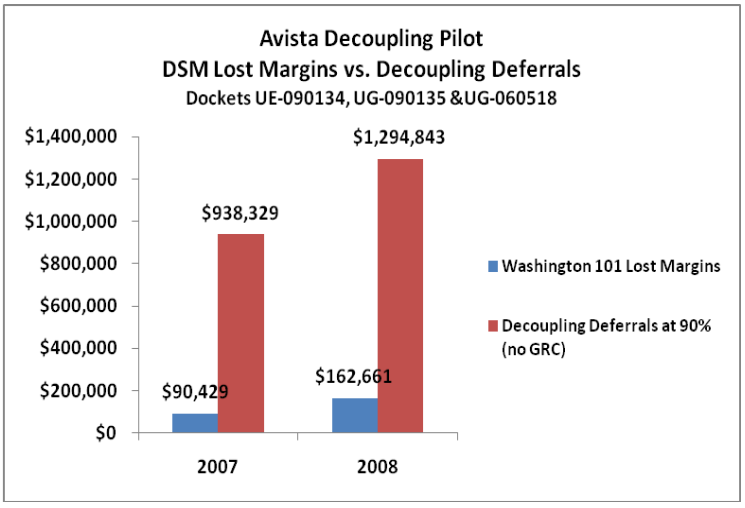
[21] PSE 2009 IRP, Chapter 1, p. 2 and Chapter 5, p. 51.
[22] Blue Ridge Phase I Report, p. 68.

been only a small fraction of the total amount which would be recovered from ratepayers under the proposed mechanism. This is a result of the broad nature of standard decoupling mechanisms, which allow for recovery of lost margins for a host of factors beyond company-sponsored DSM programs. For example, Avista's original natural gas decoupling pilot mechanism allowed for recovery of all usage factors except weather, including overall economic conditions, price elasticity, changes in building codes, and ratepayer-funded conservation measures undertaken without utility DSM rebates. During Avista's decoupling pilot, the ratio of deferred lost margin compared to the lost margin due to Company-sponsored conservation was 10:1 in 2007 and 8:1 in 2008. The Commission's order extending the pilot adopted modifications to address this by applying a "bottom-up approach," focusing on the percentage of lost margin specifically due to Company-sponsored conservation as the best method to arrive at a fair and equitable result.[23] The Commission, in this way, reduced Avista's future decoupling deferral and recovery amount from 90 percent to 45 percent of total lost margins.[24]

21. The charts below provide examples of lost margins from utility-sponsored conservation compared to utility revenue recovery under two utility decoupling proposals presented before this Commission. As evident in reviewing these examples, the ratio of lost margin resulting from utility sponsored DSM programs is very small compared to the total amount deferred and subject for recovery from ratepayers under the two decoupling proposals.[25]

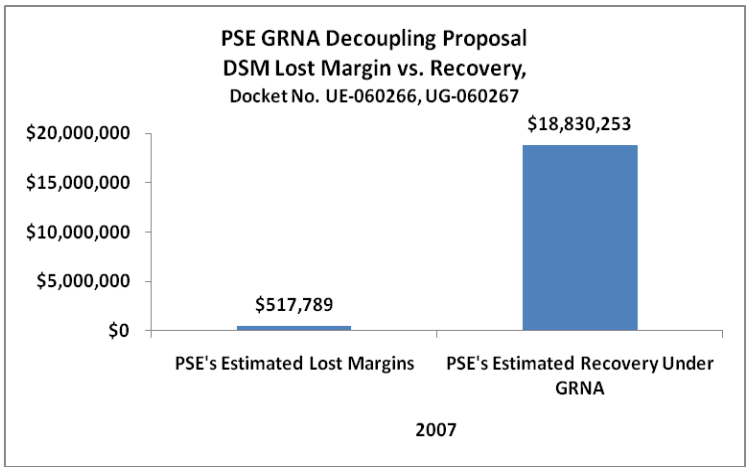
[23] Avista 2009 GRC, Order 10, pp. 115-116.
[24] *Id.*, p. 116.
[25] The lost margins and deferrals in the Avista decoupling mechanism pilot were evaluated by a third-party contractor and presented in an evaluation report. The lost margins and revenue recoveries under PSE's proposed GRNA decoupling proposal presented in the company's 2006 rate case, are estimates based on discovery responses and evidence discussed in Public Counsel's Opening Brief in that case.

Chart 1



Source: BJH-2A, Decoupling Evaluation Report by Titus (Updated, Revised) p. 45, Docket UE-090134, UG-090135 and UG-060518

Chart 2



Source: Opening Brief of Public Counsel, pp.13-14, Docket No. UE-060266, UG-060267

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How much lost margin can be attributed to other types of conservation referenced in question 6 below?

22. Lost margins primarily consist of usage reductions from causes other than company-sponsored conservation programs, as discussed further in question six below. This disproportion is shown by the data in the preceding charts.[26]

5) Direct Conservation Incentives and Rate of Return. **What is the rationale for making incentive payments to utilities for acquiring conservation resources? Is it to encourage conservation? (See questions 14-17 below relating to conservation mandates.) Is it to ensure that the utility earns a sufficient rate of return? Does an incentive program act as an effective substitute for decoupling?**

23. A primary rationale offered for decoupling/lost margin mechanisms is the need to remove financial disincentives for conservation, making the company neutral towards conservation as compared with other resources. The question posed above takes a different perspective, focusing on positive incentive. The general rationale offered for incentives tends to focus on utility culture with the idea that utility personnel will be more favorably inclined toward conservation, especially to achieving greater levels, if there is a financial reward. While there is not a bright line between the two sides of the argument, the value of incentives (rather than removal of disincentives) can be to provide positive motivation toward acquisition of conservation as opposed to merely a "neutral" indifference.

24. Public Counsel has historically been more supportive of targeted incentive payments as opposed to decoupling because they offer a more direct and precise way to obtain the ultimate

[26] "The question of 'proportionality' is critical to the alleged justification of decoupling to 'break the link' between sales and fixed cost recovery so that utilities will be more supportive of DSM efforts. If the size of decoupling deferrals is not at or near parity with gas margin revenues actually forgone by Avista as a result of DSM therm savings, it is obvious that decoupling as a regulatory remedy is not proportional and ratepayers will be made to pay rates that are not reasonable." Avista 2009 GRC, Testimony of Michael L. Brosch on behalf of Public Counsel, Exhibit No. MLB-1T, p. 15.

behavior which decoupling is also said to seek.[27] Classic decoupling only gets the utility to "neutrality" rather than to motivated behavior. In addition, decoupling mechanisms have not traditionally contained any conservation achievement requirements. The premise was simply that increased conservation would be considered by utilities if the disincentive was removed, however, typically no specific targets or requirements to actually do conservation were built in.[28] For this reason, incentive mechanisms offer an effective substitute for decoupling in terms of more directly fostering conservation. However, as question fourteen notes, the need for incentives must be viewed differently in the I-937 era where companies' conservation acquisition is a clear statutory requirement. This point is discussed below under questions 14-17.

25. The most common rationale offered for incentive payments is to encourage conservation, rather than to address rate of return issues. In Public Counsel's view, there is little if any evidence that rate of return is negatively impacted by conservation.[29] First, as a practical matter, Washington's major regulated utilities are in an era of frequent rate case filings. PSE has filed 9 rate cases since 2001.[30] Avista Utilities is currently prosecuting its fifth rate case since 2005. These nearly annual filings by definition allow the utility to request relief for any failure to earn a reasonable rate of return, and to receive a rate increase if needed to remedy the problem.

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[27] Reviewing PSE's gas decoupling proposal, the Commission observed that direct incentives "may more effectively target the goal of increasing PSE's conservation efforts than does decoupling. Incentive programs are simple to implement, easy to understand, very direct in their operation, and easier to evaluate." PSE 2006 GRC, Order 08, ¶ 69.

[28] PSE actively opposed a requirement of energy efficiency performance measurement for its gas decoupling proposal. PSE 2006 GRC, Order 08, ¶ 68, n. 51. Avista's approved decoupling mechanism includes an energy efficiency "test" that must be met before funds can be recovered from ratepayers. Avista 2009 GRC, Order 10, ¶ 299.

[29] *See* response to Question 3, discussion of Blue Ridge evaluation of PSE's ECIM analysis of the effect of the utility's conservation on the rate of return.

[30] This includes general rate cases and power cost only rate cases (PCORCs).

26. Second, the scale of the "lost margin" problem does not appear sufficient to impair rate of return. Lost margins represent only a very small percentage of total energy sales, in the range of 1 percent or lower.[31] Third, Washington law has for many years provided that a utility may receive a "bonus" rate of return for conservation investments. RCW 80.28.025. Washington's regulated utilities have not made use of this provision although conservation expenditures have risen dramatically. This would seem to provide evidence there is not a serious "rate of return" issue, since basic laws of economics would be expected to motivate recourse to the statute if a problem existed.

Details of a Conservation Incentive Mechanism

***6) Categories of Lost Margin Due to Conservation Eligible for Recovery.* Identify which, if any, of the following declines in customer use should be subject to recovery by the utility and how each could be calculated or measured.**

27. If the Commission determines that some type of incentive mechanism is appropriate for a utility, any such incentive should be limited in its design to be proportional to the lost margins that can be attributed to utility-sponsored DSM programs, as discussed in further detail below. Recovery should be dependent on the utility meeting clearly-defined DSM performance targets, subject to meaningful measurement, evaluation and verification, as well as an earnings test.

a) Margin decline from company-sponsored conservation programs that provide a rebate or that provide direct assistance with conservation-measure deployment (such as site visit evaluation).

28. Public Counsel does not presume that any gas or electric utility should necessarily be allowed to recover lost margin through an incentive mechanism of some kind. In the event that

[31] Avista 2009 GRC, Exhibit BJH-2a on behalf of Avista, *Evaluation of Avista Natural Gas Decoupling Pilot*, Prepared by Titus, Revised August 10, 2009. *See* Table C1-B, at p. 11, which shows Washington DSM savings for Schedule 101 customers, and Table J1-WA Total Annual Usage Summary, showing Schedule 101 actual and weather normalized usage.

the Commission does approve an incentive, in our view the only lost margins that should be appropriately eligible for recovery are declines due to company-sponsored conservation programs that provide a rebate for direct installation of conservation measures, if the savings estimates are reliable and have been independently verified. (Issues related to EM&V are discussed in more detail below in response to questions 18 through 21). In addition, recovery should not occur until the Commission has determined that other programmatic requirements are met that balance the interests of ratepayers and the utility, such as cost-effectiveness standards and earnings tests.

b) Information provided by the utility to the customer, such as educational programs, bill inserts, or information on the utility's website.

29. Utilities should not be allowed to recover lost margins for declines in customer use associated with educational programs and information provided from the company for two reasons. First, informational programs primarily direct customers to the utility's own programs which are specific to conservation measures and rebates. These measure-specific programs would count any savings associated with customers who participate. Associating savings from the measure-specific programs with the educational programs would result in inappropriate double-counting. Second, insofar as these programs seek to influence customers' consciousness regarding efficiency and sustainability, this outcome has not yet been measured or verified, and in that regard it is premature to attempt to identify and claim any savings from these programs.

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c) A company's share of Northwest Energy Efficiency Alliance (NEEA) regional conservation savings including market transformation that is not counted in the utility's programmatic or informational efforts. If yes, how can NEEA savings be separated from other conservation savings that occur for the purposes of a cost recovery mechanism?

30. Public Counsel has supported regional market transformation efforts, such as NEEA, in terms of the inclusion of those expenditures in utility DSM efforts funded by ratepayers. However, attempting to identify and attribute specific savings amounts associated with NEEA's efforts in order to allow for lost margin recovery raises a host of complexities. Our understanding is that NEEA tracks total market savings, then allocates those total savings across three categories: 1) "baseline" savings are an estimate of what would have occurred regardless of any intervention from utility-funded activity, 2) "local utility savings" are the savings counted directly by the utilities as part of their local programs, and lastly, 3) the "net market effects" category reflects the combined market changes due to interventions such as NEEA, that are not otherwise counted as part of the local programs or allocated to 'baseline' influence. Our understanding is that NEEA reports savings for all three categories to their members, but this last category, "net market effects," is generally viewed by the utilities as the closest measurement of NEEA's activities.

31. While the methodology described above may *allocate* savings to 'net market effects,' that is not the same as *attributing* savings specifically to NEEA's efforts. This is a critical and important distinction. Ultimately, the NEEA savings data is an estimate of conservation that may be attributed to broad regional market transformation efforts. Such calculations are performed in order to inform and guide NEEA's efforts. However, to attempt to identify a specific amount of savings that should be attributed to NEEA's efforts alone, in order to establish

rates that would compensate local utilities for the estimated lost margins due to these savings, would be an overly complex and highly theoretical exercise. As such, the resulting data, in our view, would not be rigorous and precise enough for ratemaking purposes, and thus lost margin recovery of these savings is not appropriate.

32. Public Counsel is still seeking to better understand how the utilities are calculating and reporting savings attributed to NEEA. NEEA-related expenditures and estimated savings can represent a considerable portion of a utility's conservation portfolio. PSE has estimated that during 2010-2011, NEEA programs will result in 5.4 aMW of savings, at a cost of $9.25 million funded by ratepayers through the electric tariff rider. This represents 7.6 percent of the 71 aMW savings target reflected in PSE's Energy Efficiency Services tariff filing with the Commission.[32] Avista's 2009 Electric IRP estimates that during the 2010-2011 period, 5.8 aMW of savings would be due to NEEA, which represents 27 percent of the 21.1 aMW in total savings estimated to be achieved through NEEA and Avista's local conservation programs.[33]

33. When the Commission approved PSE's pilot Electric Conservation Incentive Mechanism (ECIM), it determined that NEEA savings should be included in terms of calculating PSE's achievement toward its DSM savings target. However, because of the complexities posed by NEEA savings, which are regional in nature and might overlap with other utility programs, specific procedures had to be developed to ensure that NEEA savings were accounted for in a

[32] Puget Sound Energy 2010-2011 EES Tariff Filing, Docket Nos. UE-091859 and UG-091860, Appendix B.

[33] Avista 2009 Electric IRP, Chapter 3 – Energy Efficiency, page 3-10, Table 3.1: Current Avista Energy Efficiency Programs. The 2009 IRP shows 2.9aMW of savings due to NEEA's efforts for each year, 2010 and 2011. Avista's 2009 Energy Efficiency Annual Report indicates that NEEA savings may be somewhat lower: "Based on NEEA's current business plan, Avista expects to claim only 2.3 aMW's during 2010 based upon the impact of NEEA ventures and regional allocation of savings." UE-082272, Avista Energy Efficiency Annual Report: 2009 Performance Results, March 31, 2010, p. 13.

manner that eliminated double-counting, and correctly allocated savings to the utility's specific service area.

34. In Order 08, Docket No. UE-060266, regarding PSE's Electric Conservation Incentive Mechanism, the Commission stated its interest in allowing the utility to count savings associated with NEEA toward its DSM target, but directed parties to develop criteria that avoided double-counting savings associated with those efforts.

> At the same time, credit for multi-year conservation efforts should not be double-counted. Consequently, we direct the Company and Staff, in consultation with the CRAG and NEEA, as appropriate, to develop criteria for counting annual incremental savings from PSE's participation in NEEA efforts that reflect the Company's participation in multi-year efforts while protecting against any double-counting of savings. (¶157, emphasis added)

35. To satisfy this directive, a subcommittee of PSE's CRAG developed criteria that sought to ensure that NEEA incremental annual savings were counted appropriately and mitigated the risk of double counting savings that might have been included in the baseline for PSE's IRP and only counted savings that could be specifically related to PSE's service territory (e.g. savings from regional irrigation measures do not qualify). To do so, a "deemed value" for all NEEA savings was created. This value did not change, regardless of actual NEEA savings, so that NEEA savings would neither benefit nor harm PSE in the tracking of energy savings for the Incentive/Penalty calculations.

36. The example above regarding PSE's ECIM highlights the complexities of even attempting to count savings associated with NEEA efforts toward an annual utility DSM target.

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d) Independent customer conservation efforts (no rebate or direct utility assistance documented).

37. Independent customer conservation efforts should not be subject to recovery by the utility. Lost margins that are due to customer conservation that are not directly attributable to utility-sponsored conservation should not be eligible for recovery. Customers are acting on their own in the market, for a wide range of reasons, i.e. economic constraints, a desire to decrease usage amid increasing energy costs, concern for the environment, or simply because of an increased availability of energy efficient products. Allowing a utility to recover any lost margins associated with the independent actions of customers would allow a utility a guaranteed amount of revenue, regardless of actual expenses, overall sales volumes, or utility investments in conservation programs.

e) Conservation due to codes and standards.

38. Conservation due to codes and standards should not be subject to recovery by the utility. Providing for recovery of lost margins due to changes in codes and standards is not appropriate because it would allow a utility a guaranteed amount of revenue, regardless of actual expenses, overall sales volumes, or utility investments in conservation programs.

f) Elasticity (i.e., heating fewer rooms, lowering thermostat, et cetera).

39. Elasticity should not be subject to recovery by the utility. Allowing for recovery of lost margins due to elasticity effectively provides the utility with a guaranteed amount of revenue, regardless of actual expenses, overall sales volumes, or utility investments in conservation programs.

g) Substitution, such as switching from electric to gas, gas to electric, or to other heating sources, such as wood or thermal-solar hot water heaters.

40. Lost margins related to fuel switching should only be accounted for to the extent that it is directly sponsored by the utility and any increased usage due to the new fuel source should be accounted for and offset in the savings associated with the old fuel. For example, while the direct use of natural gas is more efficient than using natural gas to create electricity, offsetting electric use with the direct use of natural gas does result in increased usage of another energy source. This offsetting increase cannot be ignored, and any savings calculation must be reduced by an equivalent increase in usage of another fuel source.

7) Impact of Conservation Incentive Mechanism on Utility Incentives to Encourage Consumption. **If a utility recovers lost margin as calculated by installed conservation measures, does it still have an incentive to encourage customers to use more energy in some other application? Are any utilities promoting the use of more energy by its customers?**

41. Depending on the design of an incentive and/or lost margin recovery mechanism, it might allow for recovery related to conservation savings as well as the over-recovery of revenue associated with increased energy sales. If the Commission determines an incentive mechanism is appropriate, any such mechanism should be subject to an earnings test which could help prevent a utility from developing contradictory policies that serve to counteract the benefits from conservation. At this time, Public Counsel is unaware of specific utility efforts to directly promote the use of more energy by its customers. However, it is not impossible to imagine this change could take place, particularly as changing technology affords new opportunities for usage (for example, electric cars).

8) Offsets. **To what extent should any recovery of lost margin be offset by revenues associated with new load (sometimes referred to as "found margin"), including:**

a) New customers,
b) Additional load for existing customers,
c) Other?

a. Any recovery of lost margins should be offset by revenues associated with load from new customers. This reflects balanced treatment of both favorable customer trends and unfavorable usage trends that are being experienced by utilities. To not include the growth in sales volume and revenues being experienced by a Company from new customers violates the matching principle and has the effect of unreasonably increasing the decoupling deferrals that are recorded by the Company.[34] Further, it would be inappropriate to assume that a utility receives no financial benefit from customer growth between rate cases that can help to mitigate conservation effects.

For example, Avista's pilot decoupling mechanism and the mechanism as approved by the Commission includes a "New Customer Adjustment" which allows Avista to carve out and retain for its shareholders the incremental margin revenues earned from serving new customers, which Public Counsel argued was not cost-based or equitable to ratepayers.[35] In fact, if the new customer adjustment had been eliminated, the deferral would actually have been negative, resulting in refund to customers.[36]

b. Recovery of lost margins should also be offset due to additional load for existing customers. It is unreasonable to consider only one driver of changing sales volumes, such as lost energy sales stemming from utility conservation

[34] Avista 2009 GRC, Testimony of Michael L. Brosch on behalf of Public Counsel, Exhibit MLB-1T p. 25.
[35] *Id*.
[36] Avista 2009 GRC, Order 10, ¶ 266.

measures implemented, while making no other adjustments to account for the other variables that influence sales and may lead to increased customer usage or "found margins" from things like economic conditions, additional appliances being added to a home, etc.

c. Another offset, particularly on the electric side, are potential spot or wholesale market sales revenues that may accrue as a result of customer conservation. This issue was identified in the Blue Ridge interim report of the PSE ECIM, as discussed above in response to question three. This issue was also raised with respect to the proposal for an electric decoupling mechanism for PacifiCorp in the company's 2005 rate case. Public Counsel witness Jim Lazar performed a detailed analysis of the decoupling proposal, including an analysis of market forecast prices provided by PacifiCorp to measure the revenues the Company would obtain from wholesale sales (or power supply costs it would avoid) if retail sales were to decline. His conclusion was that the 1 percent per year loss of sales estimated by PacifiCorp witness Cavanagh would translate into an increase in of $6.8 million to $12.8 million in cumulative profits over a five year period. [37]

9) Application to Industrial Customers. **Should large customers be treated differently than residential or commercial customers with regard to lost revenue recovery or incentives? If so, please explain the rationale for excluding large customers.**

42. All customer classes eligible for and participating in utility-sponsored conservation should be included in the recovery of any incentive payments or lost revenues, if either is

[37] PacifiCorp 2005 GRC, Initial Brief of Public Counsel, ¶ 157-158.

deemed appropriate. A significant portion of conservation budgets can be attributed to large customers. For example, as illustrated in PSE's EES Program Results for 2009, of the $69.6 million spent in total for the electric programs, approximately $31.3 million (45 percent of the total electric expenditures) was spent on the residential sector and $29.7 million (43 percent of the total electric expenditures) was spent on the commercial and industrial sector. For PSE's gas programs, a total of $17.1 million was spent, with $11.1 million (65 percent of total gas expenditures) spent on the residential sector programs and approximately $5.0 million (29 percent of total gas expenditures) spent on commercial and industrial sector programs.[38] In 2009, PacifiCorp spent a total of nearly $6.7 million on its DSM programs. Of this, roughly $2.5 million (38 percent of total expenditures) was spent on programs in the residential sector and nearly $3.6 million (54 percent of total expenditures) was spent on programs in the commercial and industrial sectors.[39]

43. It is clear that proportionally, commercial and industrial customers receive a considerable portion of total utility DSM budgets, and they also benefit from a considerable portion of the associated savings.

44. If the point of an incentive or lost revenue recovery mechanism is to incent utility companies to undertake additional conservation, either as a least cost resource or in the process of attaining all cost-effective conservation, they should pursue savings in all customer classes, particularly where conservation might be most efficiently gained. At the same time, all customers who benefit from these programs should be included in the recovery of the incentives

[38] PSE Energy Efficiency Services Program Results, January-December 2009, updated version filed March 16, 2009. Exhibit 1: 2009 Results by Rate Schedule, Docket UE-970686.

[39] PacifiCorp 2009 Annual Review of DSM Programs-Washington, Docket UE-001457, February 12, 2010, p. 8.

that encourage this activity. Since the reduced risk or cost of adding additional resources benefits all customers, no single class of customers should be singled out for exclusion from paying for these benefits, just as no single class of customers would solely pay for the addition of a new resource.

45. The recovery of incentive payments under PSE's Electric Conservation Incentive Mechanism (ECIM), which expired at the end of 2009, collected incentive amounts in a manner that allocated the incentive across customer classes and rate schedules. Incentive amounts earned by the company were included in the calculation of rates under the Schedule 120 electric tariff rider, which implements surcharges to collect the costs incurred in providing services and programs related to the Company's electric conservation programs. Thus, the incentive amounts were distributed across customers, in a manner comparable to all other costs for PSE's conservation programs. The PSE ECIM also required that the utility achieve at least 75 percent of its stated target in both the residential sector and also the commercial and industrial sector. This ensured that the utility continued to pursue its savings in both sectors.

***10) Other Characteristics of an Incentive Mechanism.* What characteristics should an incentive mechanism include?**

- **a) Should it allow the utility to recover an absolute dollar amount? If so, how should the amount be calculated? Should recovery be based on all conservation that occurs over a given period, or be proportional to the conservation that occurs as a result of a utility's actions?**
- **b) For electric utilities, should the incentive targets be different and greater than the Energy Independence Act (EIA or I-937) targets?**
- **c) Should there be penalties for failing to achieve the incentive mechanism's target or rewards for achieving only a percentage of the target?**
- **d) Should there be an earnings test to determine if the utility is over earning?**
- **e) Should the incentive include all customer classes in the target and in the collection of the incentive payments?**

f) Are there other complementary rate making policies that should be matched with an incentive mechanism such as a pro forma adjustment to account for lower loads? Please provide details of any such proposals.

46. If the Commission determines that there is a need for financial incentives to encourage conservation, desirable characteristics of an incentive mechanism include the following: clearly defined DSM performance targets, with meaningful independent measurement, verification and reporting of results achieved by the utility relative to such targets; incentive structures designed to encourage a Company to manage DSM programs in a cost-effective manner; and administrative simplicity.[40]

a) If an incentive mechanism is determined to be necessary by the Commission, recovery should be proportional to utility-sponsored conservation, not to all conservation that occurs over a given period. A possible alternative approach is to set an incentive amount that is not specifically tied to lost margins, but instead rewards conservation achievement toward a DSM target.

An incentive mechanism also could be designed to simply recover an absolute dollar amount. This may be appropriate for an incentive that is not tied to lost margins but instead rewards achievement against a conservation target. In the case of an incentive that is designed to be proportional to utility conservation achievements, reward amounts should be set for meeting or exceeding a specific targeted amount of achieved conservation, while allowing for recovery of incentives beyond a target. This framework provides the possibility of incenting higher levels of incremental conservation and could inspire the Company to keep working to capture this least cost

[40] Avista 2009 GRC, Testimony of Michael L. Brosch on behalf of Public Counsel, MLB-1T, pp. 41-42.

resource on behalf of its ratepayers, should additional opportunities for cost-effective conservation emerge.

Any incentive mechanism should be designed on an individual utility basis in order to specifically calibrate it to that utility's programs and associated lost margins.

b) In setting incentive targets for electric utilities it is important to understand that the conservation targets developed for these utilities under the EIA may include conservation sources that are not tied to utility sponsored conservation programs, such as production and distribution efficiency. Therefore, targets tied to an incentive mechanism for electric utility may be different than those developed under EIA as these would exclude sources not tied utility-sponsored conservation programs. This is a complexity that needs to be addressed in the design of any incentive mechanism for electric utilities.

c) Yes, an incentive mechanism should be designed so that penalties are accrued if the Company does not meet their conservation targets. This will ensure that the Company has strong incentives to achieve its conservation targets and serves to protect ratepayers from factors that might negatively impact a Company's emphasis on conservation programs. No incentive payments should be received if a Company does not reach its targets (i.e. only reaches a percentage of its target). Each mechanism and penalties associated with it, should be designed on an individual utility basis in order to specifically calibrate it to that utility's programs and associated lost margins.

d) Yes, an earnings test is an important way to ensure that an incentive mechanism is not producing windfall revenues in comparison to margins lost from conservation

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programs. The Commission addressed a similar concern in its Order regarding Cascade's decoupling proposal when it said, "…new regulatory mechanisms heighten concerns that a utility's earnings may exceed a reasonable rate of return."[41] In that case the president of Cascade stated on the record that if decoupling were approved, the company would likely receive additional revenue without a rate case.[42] Thus, the Commission implemented an earnings test to prevent potential over-earning by the Company. This earnings test set an earnings cap based on a stipulated overall rate of return.[43] Notably, Cascade Natural Gas has failed the earnings test each year since the decoupling pilot was implemented which means they have exceeded their authorized rate of return, and as result, the company has not recovered any of the deferred amounts associated with its decoupling mechanism.

e) Yes, an incentive mechanism should include all rate schedules and customer classes in the target and in the collection of incentive payments to recognize that all rate schedules participate and benefit from utility conservation programs. See also the response to question 9 for a description of PSE's ECIM and how all customers contribute to the incentive payments under that mechanism.

f) Additional rate making policies coupled with an incentive mechanism would likely increase the complexity and administrative burden of an incentive mechanism. In considering a pro-forma adjustment to account for lower loads, it must first be determined whether, indeed, the utility is experiencing decreasing electric or natural

[41] *WUTC v. Cascade Natural Gas Corp.,* Docket UG-060256, Order 05, January 12, 2007, ¶ 63 (hereafter "Cascade 2006 GRC").
[42] *Id*., ¶ 79.
[43] *Id*., ¶ 81.

gas load forecasts. Further, any pro forma adjustment that only takes into account changes in electric and natural gas sales volume due to utility-sponsored DSM programs would not be proper as there are many different reasons beyond utility-sponsored conservation that drive changes in electric and natural gas sales, including the number of customers served by the utility, price elasticity, economic conditions, additional appliances added to a home, and changes in building codes, to address a few. Any "offsets" to load that result from increased customer usage would need to be taken into account.[44]

Impact on Rates

***11) Impact on Various Classes of Customers.* How should the costs of an incentive mechanism be spread among the various rate classes? Are transport customers appropriately protected from a recovery mechanism's costs?**

47. In the event the Commission determines an incentive mechanism is appropriate for a utility, the costs associated with the mechanism should be borne by all retail customers. All retail customers benefit from utility-sponsored conservation programs, and typically, all retail customer classes contribute to the costs for such programs (e.g. through a tariff rider that appears on the customer's bill or as part of the Purchased Gas Adjustment). Notably, the costs of utility conservation programs, which are fully funded by ratepayers, have risen dramatically in recent years. The same customer classes that contribute to conservation program costs should share in paying for the costs of any approved incentive mechanism. As discussed above in response to question nine, the costs of PSE's Electric Incentive Mechanism were borne by all ratepayer classes who contribute to the DSM budget.

[44] *See* PSE 2009 GRC, Testimony of James R. Dittmer on Behalf of Public Counsel, Exhibit JRD-11, pp. 30-44.

48. Public Counsel does not take a position on transport customers at this time.

12) Impact on Low Income Households. **Should the design of an incentive mechanism consider its impact on low-income customers? Would a lost margin recovery mechanism cause low-income households to bear a higher percentage of system costs? Are existing utility conservation programs for the residential class accessible to low-income customers? If not, is the relationship between bill impacts and access to programs for low-income equitable?**

49. Any increase to the billed rates of customers, including the effects of possible incentive payments, will be felt more strongly by low-income customers than other customer classes, so it follows that an incentive mechanism should be designed to consider these effects and attempt to mitigate the impact on low-income customers. Public Counsel believes it is important for all customers eligible for and taking part in utility-sponsored conservation to be treated equally in recovery of incentives that encourage this activity, but recognizes that low-income customers (1) feel the effects of bill increases more drastically, and (2) may not have equal access to residential DSM programs due to the cost.

50. A lost margin recovery mechanism, depending on its design, could very well cause low-income households to bear a higher percentage of system costs. For example, in Docket Nos. UE-090134, UG-090135 &UG-060518, the Energy Project recommended that the Commission terminate Avista's decoupling pilot mechanism because of evidence that limited income customers and many more payment-troubled customers that may not qualify as limited-income customers under Avista's guidelines, "pay higher prices for natural gas service but do not receive any of the potential direct benefits from the more expensive DSM programs Avista has implemented." Citing the Titus report, the Energy Project testified that Avista's DSM expenditures on Washington residential customers increased 25 percent in 2007 and another 50 percent in 2008, while expenditures for limited income customers increased 17 percent in 2007

and only 12 percent in 2008. In the case of Avista, the ratio of dollars spent on limited income customers dropped from 1 in 6 in 2007 to 1 in 8 in 2008.[45] Consequently, if a decoupling mechanism or other lost margin mechanism is not designed to incent the utility to take any new actions with respect to increased funding for low-income programs, low-income customers may end up paying costs for additional DSM program funding that are not equal to a low-income customers ability to participate in these programs.

51. Public Counsel understands that a great majority of existing utility conservation programs are not accessible to low-income customers as they are cost-prohibitive. Many measures, especially on the gas side, are simply not affordable to low-income customers. This would appear to lead to an inequitable relationship between low-income bill impact and access to programs. Further, low-income participation rates for even low-income specific DSM programs have been shown, in some instances, to be very low. For example, according to the Energy Project, only 1.2 percent of Avista's limited income population participates in the low-income DSM programs.[46]

***13) Impact on Utility Incentives.* Does the recovery of lost margin from conservation provide an incentive for the utility to control costs? What is the incentive to minimize purchased gas adjustment (PGA) costs (within some risk level) if the utility is compensated for any decline in sales from conservation?**

52. No. In fact, recovery of lost margins reduces the incentive for the utility to control costs. Under traditional rate regulation, once an authorized revenue and rate of return level has been set for the utility, the company has a built-in incentive to control its costs so that it can achieve the authorized level of revenue and return. Indeed, if the company does a good job in controlling

[45] Avista 2009 GRC, Order 10, ¶ 272.
[46] Avista 2009 GRC, Testimony of Barbara R. Alexander on behalf of the Energy Project, Exhibit BRA-1T, p. 13.

costs and growing its revenues, it can earn better than its authorized levels and higher earnings are retained by shareholders until the next rate case, a further incentive to manage cost. However, since a lost margin or decoupling mechanism, by definition, insulates a portion of revenue levels from decline, there is less need for the company to manage its costs to maintain revenue and return. The lost margin mechanism stabilizes company revenue regardless of management actions.

53. With respect to Purchased Gas Adjustments specifically, cost-control incentives are already substantially reduced or eliminated. The PGA routinely passes through the company's natural gas commodity cost directly to consumers without substantial review

Relationship of Incentives to Conservation Mandates

14) Impact of Conservation Mandate in I-937. **In light of the legal requirement for an electric utility to pursue all available conservation that is cost-effective, reliable and feasible under I-937, is it appropriate to provide an incentive to electric utilities for conservation?**

54. Washington's regulated utilities are required by I-937 (the Energy Independence Act), RCW 19.285.040(1)(b) to identify two year conservation targets. Once the target is identified, the utility is then required by statute to meet the target. If it fails to do so, it must pay financial penalties.[47] The EIA also states that the Commission "may consider providing positive incentives for an investor-owned utility to exceed the targets established in RCW 19.285.040."[48]

55. The statute, as written, already provides incentives to a utility to achieve conservation in several ways. First, there is an inherent incentive provided by the legal obligation itself. Second, the potential for penalties if targets are not met creates a tangible financial incentive to achieve

[47] RCW 19.285.060(1).
[48] RCW 19.285.060(4).

conservation. In this regard, the utility has at least the same incentive as any individual or business to comply with any law or regulation. There is not ordinarily an expectation by individuals or businesses that they will receive special additional compensation for following the law. In this instance, as noted elsewhere in these comments, acquisition of cost-effective conservation by utilities, using ratepayer funds, actually provides a least cost, lower risk, lower emission resource than construction of a generating facility, and thus is economically advantageous to the company.

***14*.5) *State greenhouse gas emission reduction goal (70.235.020).* How would removing the linkage between the number of kilowatt hours sold and financial returns for utilities impact the state's ability to meet its statutory greenhouse (GHG) emission reduction limits (RCW 70.235.020)?**

56. Public Counsel does not have a comment on this issue.

***15) *Incentives to Exceed I-937 Targets.* Under the EIA, the Commission may consider providing positive incentives for an investor-owned utility to exceed the conservation targets established in RCW 19.285.040. Do ratepayers benefit from encouraging the utility to pursue conservation that is not cost-effective and therefore beyond its target?**

57. While the EIA provides that the Commission may at its discretion adopt positive incentives, this provision only authorizes incentives for exceeding the target. The EIA provides no authority for payment of incentives to utilities for simply meeting the statutory target. As the issue statement implicitly observes, the statutory target is the identification of all achievable, cost-effective, feasible conservation. By definition any additional conservation achieved beyond this would not be cost-effective. In this sense, ratepayers would experience negative economic impacts from payment of incentives in two ways. First, they would be paying for acquisition of non cost-effective resources that would be more expensive than a given alternative

(e.g. a natural gas-fired plant, a power purchase contract). This appears to be contrary to the fundamental ratemaking principle that customers should pay only for prudently incurred expenses and investments. Second, ratepayers would pay the cost of whatever incentive was established. For these reasons ratepayers would not benefit economically from incentives to exceed the conservation target. Since the statute permits incentives, however, the Commission has some discretion to adopt them. For the reasons stated, it appears the Commission should require a compelling policy justification to establish incentives and any mechanism should seek to avoid or minimize the creation of perverse incentives.

16) Impact of Disincentive. **As investor-owned electric utilities currently acquire more than their share of the Northwest Power and Conservation Council's assessment of conservation potential, does a disincentive to encourage conservation actually exist?**

58. It is difficult to find evidence that any disincentive actually exists. The data shows that conservation acquisition for Washington utilities has been very healthy, despite the general absence of incentive payments, and even prior to adoption of the I-937 requirements or the approval of decoupling programs. Companies have not made use of the rate of return incentive provided for in RCW 80.28.025. Utilities widely advertise their commitment to and achievement of conservation and renewable programs to their customers and to the public at large.

59. From a corporate relations perspective, a utility gains as the administrator of an energy efficiency program. For example, DSM programs have value for utilities because they provide a positive opportunity to interface with their customers, and offer a benefit for customers at a time of near constant rate increases. A recent American Gas Association report stated that utility gas

energy efficiency programs provide an opportunity for utilities to "contribute to the communities in which they operate."[49]

17) Natural Gas Planning. Does the lowest cost mix of resources described in WAC 480-90-238(2)(a)-(b) (natural gas integrated resource planning) require a gas utility to pursue all cost-effective conservation, i.e., conservation that has costs equal to or less than supply side resources?

60. Yes, as a general proposition, gas utilities are required to pursue all cost-effective conservation, insofar as it is achievable and feasible, as these limitations are provided for in the rule. Subsection (2)(b) provides a number of considerations that must be taken into account as part of the determination of what is the least-cost, cost-effective resource mix. The Commission's integrated resource planning [50] rule for natural gas utilities cited in the issue statement contains a statement of purpose as follows:

> (1) Purpose. Each natural gas utility regulated by the commission has the responsibility to meet system demand with the least cost mix of natural gas supply and conservation. In furtherance of that responsibility, each natural gas utility must develop an "integrated resource plan."

The provisions cited in the question are contained in the definitional section and provide:

> (2) Definitions.
> (a) "Integrated resource plan" or "plan" means a plan describing the mix of natural gas supply and conservation designated to meet current and future needs at the lowest reasonable cost to the utility and its ratepayers.
>
> (b) "Lowest reasonable cost" means the lowest cost mix of resources determined through a detailed and consistent analysis of a wide range of commercially available sources. At a minimum, this analysis must consider resource costs, market-volatility risks, demand-side resource uncertainties, the risks imposed on

[49] *Natural Gas Utility Energy Efficiency Portfolios Report, 2007 Program Year*, American Gas Association, December 2008, Introduction, p. 2.
[50] "integrated resource plan" (IRP) is also referred to as "least-cost plan."

ratepayers, resource effect on system operations, public policies regarding resource preference adopted by Washington state or the federal government, the cost of risks associated with environmental effects including emissions of carbon dioxide, and the need for security of supply.

Evaluation, Measurement and Verification

18) Use Per Customer as a Metric. **Is use-per-customer for individual rate classes a useful metric for identifying conservation effects?**

61. No, use-per-customer is not a useful metric for identifying conservation effects. There are numerous variables that impact sales and contribute to a calculation of usage per customer. It is incorrect to assume that change in use per customer, or lack thereof, is solely attributable to the effects of utility-sponsored DSM, or even to conservation effects more broadly. Attempting to attribute any changes in use to one element (conservation), ignores equal and offsetting elements that may also have an impact (such as the effects of a greater number of appliances and devices in the home, including flat screen televisions, computers, DVRs, etc.), that require additional electricity more than offsetting the reduced usage from the installation of a CFL. Furthermore, there is a long-standing downward trend in gas use per customer that is driven largely by the continual replacement of inefficient older home appliances, improved codes and standards, and ratepayers' independently funded efforts to conserve, particularly in response to recent high natural gas prices. Usage may also change due to price elasticity responses that drive customers to curtail their electricity or natural gas consumption.

19) Load Forecasting. **Load forecasting is a key input for calculating conservation effects. How can load forecasting become more reliable? How does conservation get accurately incorporated into a company's load forecast?**

62. Load forecasting may be a broader issue, to be examined separately from EM&V. It would be helpful for the utilities to provide some information regarding the accuracy of their

load forecasts in recent years, as well as clear explanations of how they account for historical program participation and achievements in forecasting load. To the extent load forecasting models examine trends in customer usage over time in order to predict future loads, they may already reflect and capture reductions in usage due to conservation effects. For example, PSE estimates its "technical" and "achievable technical" energy efficiency potential based on forecasts of future consumption absent any utility program activities. However, consumption forecasts account for the past savings PSE has acquired. In explaining this process, the Comprehensive Assessment of Demand Side Resource Potentials (Appendix L.1 to PSE's 2009 IRP) states, "While consumption forecasts account for the past savings PSE has acquired, the estimated potential is inclusive of—not in addition to—current or forecasted program savings."[51] Load forecasting is a sophisticated but highly complex endeavor, that may or may not adequately and accurately incorporate conservation effects. It would be beneficial, as part of this rulemaking, to gain a better understanding as to how the utilities take conservation effects into account in their load forecasts, and how that relates to the utilities' own estimation of their achievable conservation potential.

20) Methods for EM&V. **Should the Commission establish a method, or general guidelines for an evaluation, measurement and verification (EM&V) methodology?**

- **a) What role should a third party evaluator of EM&V play?**
- **b) Are EM&V methods accurate enough to use the history of individual customer usage as the basis for determining the payments in an incentive mechanism?**
- **c) What role should the Regional Technical Forum play in EM&V issues?**

[51] PSE 2009 IRP, Appendix L.1, Comprehensive Assessment of Demand Side Resource Potentials, p. 11.

63. Yes, Public Counsel believes a collaborative established by the Commission to adopt a set of EM&V protocols and/or methodologies for all Washington utilities, both electric and gas, would serve to standardize and improve utility EM&V methods and ensure confidence and transparency in savings associated with utility conservation programs. Due to the technical nature of the subject matter, we recommend that an EM&V expert, as well as a facilitator, should be retained to assist with the development of such guidelines, either as part of a rulemaking or other generic proceeding.

64. The need for rigorous EM&V of utility-sponsored DSM programs is essential in determining the actual impact (therm or kilowatt hour savings) of any Company's DSM programs. The Commission acknowledged this in their Order in the Avista decoupling pilot case, stating, "We recognize that cost-effectiveness, and therefore prudence of programmatic DSM expenses and lost margin recovery under any decoupling or incentive mechanism rests on the evaluation, measurement, and verification of energy savings achieved." [52]

65. In addition, the Commission recently approved, with conditions, Avista's electric conservation target filed in compliance with the Energy Independence Act, or "I-937." Condition 6, parts A-F, address EM&V and notably, require the Company to provide opportunities for the Avista's energy efficiency advisory group to assist with the development of EM&V protocols for the Company's conservation programs.

66. While these steps taken by the Commission represent very positive improvements to EM&V going forward, they are not applicable to all utilities at this time. EM&V has risen to

[52] Avista 2009 GRC, Order 10, ¶ 71.

much greater importance, due in part to the following:

- Ratepayer funding of utility conservation programs has increased, very sharply in some instances. PSE's conservation budget has increased from about $25 million annually in 2005, to $100 million annually for 2010 and 2011.[53] As the utility conservation programs expand, the need to measure and verify the savings has also grown and intensified, in order to ensure the funds are being directed toward prudent, cost-effective programs.
- Savings associated with utility conservation programs is a critical component in determining the cost-effectiveness of the programs. Therefore, it is important that these savings estimates are reasonably accurate.
- Special rate mechanisms, such as gas decoupling for Avista and Cascade, allow for additional revenue recovery from ratepayers in between rate cases, with the amount collected determined in part by the 'DSM Test,' which uses savings estimates to determine whether the utility met its DSM target.
- Recent attention on current EM&V efforts of utilities has revealed mixed and different approaches. Some utilities have retained independent third party evaluators to assess their programs, while others have done only limited internal reviews of some programs.

67. Based on this elevated importance, it would be very beneficial for the Commission, with the assistance of stakeholder and utilities, to develop general EM&V guidelines, protocols and/or standards that could be applied across all utilities in Washington.

[53] Energy Efficiency Services Program Results, January – December 2005, UE-970686, February 14, 2006, p. 1 provides 2005 data. 2010-2011 data is shown in Puget Sound Energy 2010-2011 EES Tariff Filing, Docket Nos. UE-091859 and UG-091860, Appendix B.

a) What role should a third-party evaluator of EM&V play?

68. A third-party evaluator of EM&V serves the very valuable benefit of offering an unbiased, independent and expert opinion of the savings claimed for the program under review. In this regard a third party evaluator plays a critical role as a neutral, independent evaluator and verifier of the savings associated with utility DSM programs. Priority should be placed on utilizing third party evaluators to examine the largest programs, in terms of savings and expenditures. Review should include impact analysis (e.g. analysis of energy consumption to determine if savings have been realized) and process (e.g. has the program been implemented as designed? Are there any recommendations for process improvements or program administration or implementation procedures?).

69. As provided in condition 6(f) of the Commission's order approving Avista's I-937 electric conservation targets, "Avista must spend between three (3) and six (6) percent of its conservation budget on evaluation, measurement, and verification (EM&V), including a reasonable proportion on independent, third-party EM&V."[54] It also provides that an annual independent, third-party EM&V report involving analysis of both program impacts and process impacts must be completed. Public Counsel supported these conditions and recommends that independent third-party evaluation be completed for all the major programs of all Washington investor-owned utilities.

b) Are EM&V methods accurate enough to use the history of individual customer usage as the basis for determining payments in an incentive mechanism?

70. No. EM&V is evolving with the utilities, and hopefully improving. As stated above, the record of the utilities on EM&V has been mixed. The primary purpose of EM&V should be to

evaluate the savings of conservation programs, to inform program design and determine cost-effectiveness.

71. As discussed above in response to question eighteen, individual usage per customer is not a useful metric for identifying conservation effects.

c) What role should the Regional Technical Forum play in EM&V issues?

72. The Regional Technical Forum (RTF) has historically played an important role on EM&V issues, and should likely continue to do so. It is not clear, however, whether the RTF has sufficient resources and organizational structure to effectively address EM&V issues. In addition, the RTF does not address EM&V issues related to natural gas efficiency measures.

***21) Impact on Cost-Effectiveness of Conservation Measures.* If lost margin is recovered in rates, should the cost be included in the cost-effectiveness test? How much would the inclusion of those costs decrease the amount of conservation achievable under the cost-effective threshold?**

73. This is a subject that is worth further consideration by the Commission. As utilities argue that they must recover any lost margins associated with company-sponsored DSM in order to remove any disincentive to promote these programs, lost margin costs associated with the programs may seemingly become inseparable from the programmatic costs of the conservation programs.

74. In the two year interim evaluation of PSE's electric conservation incentive mechanism, Blue Ridge conducted an analysis to determine whether PSE's portfolio of electric energy efficiency programs were still cost-effective when the amount of the incentive was added as a cost. The results showed that for 2007 and 2008, the Cost/Benefit ratios of the Utility Cost (UC)

[54] Docket UE-100176, Order 01, Order Approving Avista's Ten-Year Achievable Conservation Potential and Biennial Conservation Targets, May 13, 2010, ¶ 62.

and the Total Resource Cost (TRC) declined, but stayed above 1.0.[55] However, PSE's UC and TRC were not on the verge of failing either test. For a utility with programs that are closer to the 1.0 threshold, the additional cost of lost margin recovery or incentive payments could be enough to cause the entire portfolio to fail the cost effectiveness standards.

Relationship of Conservation Incentives to Utility Return on Equity

***22) Effect of Incentive Mechanism on Allowed Return on Equity.* Should adoption of an incentive or lost margin/decoupling mechanism require a downward adjustment in the utility's return on equity?**

75. Decoupling or lost margin mechanisms shift risk from shareholders to ratepayers by stabilizing utility revenue, effectively guaranteeing a certain level of cost recovery. As the Commission observed in its review of PSE's gas decoupling proposal filed in 2006, "[f]or all its ostensible advantages, decoupling also has disadvantages, notably the shifting of risk to ratepayers."[56] Lost margin mechanisms have a similar effect. Because lower risk investments by definition require a lower return, the return on equity provided to utility investors (and collected in rates) must be reduced to reflect this shift. In its recent approval of a modified decoupling mechanism for Avista, the Commission acknowledged "that reducing a Company's risk can result in a reduction of its return on equity."[57]

76. An incentive mechanism, as distinct from a lost margin/decoupling mechanism, would not necessarily require a downward adjustment to the return on equity. If the amount of the

[55] Blue Ridge Phase I Report, p. 61 In order to be considered cost-effective, the result of the cost-benefit analysis should be greater than 1.0.

[56] PSE 2006 GRC, Order 08, ¶ 61.

[57] The Commission withheld judgment on a modification of the return because the record was not adequate to address the issue, but left the issue open to be addressed by parties in a future proceeding. Avista 2009 GRC, Order 10, ¶ 308. In declining to adopt PacifiCorp's electric decoupling proposal in 2006, the Commission listed as one of the necessary components for a proper decoupling proposal detailed information about the "rate of return implications." Pacificorp 2005 GRC, Order 04, ¶ 109.

incentive is independent of any calculation of lost margin, and is not designed to replace lost margin, and adjustment would not be needed.

23) Incentive Rate of Return. **Should a utility's rate of return be increased for sponsoring and administering conservation programs? If so, please explain. Should a utility earn a return on monies collected from ratepayers to fund its conservation programs? If so, please explain. Would the amount of energy efficiency offered by the utility increase under either of the above circumstances?**

77. Washington law currently allows for a rate of return enhancement for investments in energy efficiency. RCW 80.28.025. As noted above, Washington's regulated utilities have not made use of this provision, but have nonetheless actively pursued and expanded conservation programs and expenditures without this type of additional financial incentive. Apart from the statutory provision, it is not clear that there is a compelling rationale for increasing rate of return as a reward for sponsoring and administering conservation. Conservation offers a lower cost, lower risk, lower emissions resource for utilities to meet load.[58] As such, conservation makes good business sense. In addition, of course, companies are legally required to pursue cost effective conservation by the Energy Independence Act and pay penalties if they fail to meet targets.

78. Allowing a return to a utility on ratepayer monies provided for conservation would be inequitable, and would not be appropriate. This would simply provide a windfall to shareholders for "investments" which they did not fund. Ratepayers would be asked to pay not only for the conservation programs, which they do now, in full, but also to provide shareholders a profit on the funds which ratepayers themselves contributed.

[58] PSE 2009 IRP, Chapter 1, p. 2 and Chapter 5, p. 51.

79. It is speculative at best whether the amount of energy efficiency offered by the utility would increase under either of the above approaches. A flaw in traditional decoupling proposals has been the absence of any enforceable commitment to achieve specific incremental amounts of conservation above the status quo in return for the benefits of decoupling.[59] Similarly, merely offering a "bonus" rate of return to a utility with no requirement of tangible improvement in conservation achievement is a misuse of ratepayer funds. Companies' active and successful efforts to pursue cost effective conservation to date, coupled with the existence of legal requirements under the EIA and Commission rules create the substantial possibility that customers would be paying a rate of return "adder" for conservation programs that would be happening anyway.

Other Issues

***24) Other Issues.* Comment on any other issue relevant to this inquiry that is not covered above.**

80. Public Counsel does not have any comment on other issues at this time.

[59] *See, e.g.,* PSE 2006 GRC, Order 08, ¶¶ 67-68 and n. 51 (noting that PSE gas decoupling proposal actively opposed inclusion of specific conservation goals).